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ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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DATE: FEBRUARY 26, 2003

DOCKET NO: S-03486A-02-0000

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Marc Stern. The recommendation has been filed in the form of an Opinion and Order on:

DAVID R. KRIZMAN
(NOTICE OF OPPORTUNITY)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

MARCH 7, 2003

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

MARCH 20, 2003

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602)542-4250.

Arizona Corporation Commission
DOCKETED

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BRIAN C. MCNEIL
EXECUTIVE SECRETARY

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

3 MARC SPITZER, Chairman
4 JIM IRVIN
5 WILLIAM A. MUNDELL
6 JEFF HATCH-MILLER
7 MIKE GLEASON

8 IN THE MATTER OF:

9 DAVID R. KRIZMAN
10 3620 N. Lynford Place
11 Tucson, AZ 85749

DOCKET NO. S-03486A-02-0000

DECISION NO. _____

OPINION AND ORDER

9 DATE OF PRE-HEARING CONFERENCE: July 11, 2002

10 DATE OF HEARING: December 11, 2002

11 PLACE OF HEARING: Phoenix, Arizona

12 ADMINISTRATIVE LAW JUDGE: Marc E. Stern

13 APPEARANCES: Mr. Phillip A. Hofling, Special Assistant
14 Attorney General, on behalf of the Securities
15 Division of the Arizona Corporation
Commission

16 **BY THE COMMISSION:**

17 On May 31, 2002, the Securities Division ("Division") of the Arizona Corporation Commission
18 ("Commission") filed a Notice of Opportunity for Hearing ("Notice") against David R. Krizman
19 ("Respondent") in which the Division alleged multiple violations of the Arizona Securities Act ("Act")
20 in connection with the offer and sale of securities in the form of viatical settlements and/or investment
21 contracts.

22 Respondent Krizman was duly served with a copy of the Notice.

23 On June 18, 2002, Walter L. Baumgardner, a Michigan attorney, filed a request for hearing for
24 the Respondent.

25 On June 25, 2002, by Procedural Order, a pre-hearing conference was scheduled for July 11,
26 2002 and Mr. Baumgardner was directed to comply with Rule 33(d) of the Arizona Supreme Court.

27 On July 11, 2002, at the pre-hearing conference, counsel for the Division was present. Neither
28 Respondent nor Respondent's counsel appeared. Counsel for the Division indicated that settlement

1 negotiations for a Consent Order were being conducted and requested a hearing be scheduled in 60 to 90
2 days if a Consent Order was not approved in the interim.

3 On July 12, 2002, by Procedural Order, a hearing was scheduled for October 1, 2002.

4 On September 27, 2002, the Division filed a Motion to Continue the proceeding for an additional
5 60 days as the parties attempted to finalize a Consent Order to be approved by the Commission.

6 On September 30, 2002, by Procedural Order, the hearing was continued to December 11, 2002
7 pending approval of a Consent Order by the Commission.

8 On December 4, 2002, the Division filed its List of Witnesses and Documentary Evidence.
9 Respondent did not file a List of Witnesses and Documentary Evidence.

10 On December 11, 2002, a full public hearing was commenced before a duly authorized
11 Administrative Law Judge of the Commission at its offices in Phoenix, Arizona. Counsel for the
12 Division appeared. Neither Respondent nor Respondent's counsel appeared at the hearing. During the
13 course of the proceeding, testimony was taken from two investor witnesses, a Division special
14 investigator and a Division senior financial institution examiner. Nineteen exhibits were admitted
15 into evidence.

16 On January 27, 2003, the Division submitted its Post-Hearing Memorandum.

17 * * * * *

18 Having considered the entire record herein and being fully advised in the premises, the
19 Commission finds, concludes, and orders that:

20 **FINDINGS OF FACT**

21 1. Respondent David R. Krizman, whose last known address is 3620 N. Lynford Place,
22 Tucson, Arizona 85749, was a securities salesman registered in Arizona from August 21, 1997 through
23 March 1, 2002 with SunAmerica Securities, Inc. ("SunAmerica").

24 2. On May 31, 2002, the Division filed a Notice against David R. Krizman alleging
25 multiple violations of the Act in connection with the offer and sale of securities in the form of viatical
26 settlements and/or investment contracts.

27 3. Respondent was duly served and requested a hearing.
28

1 4. Pursuant to a Division subpoena, Respondent Krizman appeared at the Division's offices
2 and testified in an examination under oath ("EUO") on May 1, 2002.

3 5. During his EUO, Respondent Krizman described how he did business as an entity called
4 "Advanced Funding" to keep his viatical settlement sales apart from and unknown to his supervisors at
5 SunAmerica.

6 6. On May 1, 1998, Respondent Krizman, dba Advanced Funding, entered into a Sales
7 Agent Agreement (the "Agent Agreement") with The Alpha Capital Group, LLC ("Alpha"), 104 E. 40th
8 Street, Suite 703, New York, NY 10016, for the purpose of offering and selling viatical settlement
9 contracts offered by Alpha.

10 7. The Agent Agreement between Krizman and Alpha provided for a commission payment
11 to Mr. Krizman of 15% of the amount of money raised from the sale of each contestable viatical policy.
12 If the sale was for a non-contestable policy, then the commission rate decreased to 8%.

13 8. During his EUO, Mr. Krizman furnished documents which showed that he sold Alpha
14 viatical contracts to six Arizona residents. He provided four copies of Agency Agreements entered into
15 between Respondent Krizman as the Agent of Alpha with four of his Arizona clients, Lupe Cardenas,
16 Elaine Haber (formerly Green), Gloria Martinez and Joan Towner. These Agency Agreements were
17 used for the purchase of contestable Alpha viatical contracts.

18 9. Additional documents provided by Respondent Krizman during his EUO establish that
19 a fifth Arizona resident, Steven Weinstein, purchased three contestable Alpha viatical contracts from
20 Respondent Krizman.

21 10. A sixth Arizona investor, Russell Le Blanc, filed a complaint with the Division
22 concerning his purchase of five contestable Alpha viatical contracts through Respondent Krizman.
23 He included a copy of an Agency Agreement with his complaint reflecting his viatical investment.

24 11. The record establishes that Respondent Krizman sold Alpha viatical contracts to the six
25 above-identified Arizona residents who invested a total of \$439,715.62 while he was employed by
26 SunAmerica as a registered securities salesman as follows:
27
28

| <u>Investor</u> | <u>Date of Agency Agreement</u> | <u>Amount Invested</u> |
|---|---------------------------------|------------------------|
| Russell E. Le Blanc | May 6, 1998 | \$184,000.00 |
| Lupe S. Cardenas | May 7, 1998 | \$58,715.62 |
| Steven Weinstein | June 9, 1998 | \$97,000.00 |
| Gloria M. Martinez | June 15, 1998 | \$35,000.00 |
| Joan Towner | May 11, 1998 | \$20,000.00 |
| Elaine B. Haber (formerly Elaine B. Green Survivors Trust) | August 25, 1998 | \$45,000.00 |

12. Division special investigator Robert Jordon testified that Alpha was not registered with the Division and that Alpha's viatical contracts sold to the Arizona investors were not registered as securities with the Division and that they were not exempt from registration.

13. Documents provided by Respondent Krizman during his EUO establish that he was paid commissions totaling \$31,339.36 for sale of the Alpha viatical contracts to investors Cardenas, Martinez, Towner and Weinstein.

14. It appears that Respondent Krizman would also have earned an additional \$33,225.00 in commissions from the sale of contestable Alpha viatical contracts to investors Haber and Le Blanc based on Respondent Krizman's EUO testimony wherein he stated he earned a 15% commission on his contestable viatical sales.

15. Mrs. Lupe Cardenas testified telephonically from Tucson that she is a 74 year old retired secretary/bookkeeper with a high school degree and one year of commercial training.

16. Mrs. Cardenas was an inexperienced investor when she first met Respondent Krizman. Her investment experience had been limited to bank certificates of deposit. She met Respondent Krizman, who at the time was selling stocks and bonds for SunAmerica at her bank and began investing in SunAmerica offerings.

17. According to Mrs. Cardenas, her stock investments were declining in value and she asked Respondent Krizman if he could sell her a safer investment.

1 18. On May 7, 1998, Respondent Krizman met with Mrs. Cardenas at her home and
2 discussed Alpha's viatical investment program. At the end of that visit she signed the Agency
3 Agreement investing \$58,715.02.

4 19. Mrs. Cardenas relied solely on Respondent Krizman's expertise and her trust in him.
5 Due to her trust in Mr. Krizman, she believed the Alpha viatical contract was not risky and that she
6 could not lose her investment because she believed that she was buying life insurance.

7 20. Mrs. Cardenas did not recall hearing the term viatical and testified she does not know
8 what a viatical is or how it works.

9 21. Mrs. Cardenas panicked after she invested when she learned that she invested in
10 insurance policies insuring the lives of persons with AIDS but Respondent Krizman advised her to set
11 her Alpha investment aside and to not worry further.

12 22. When Mrs. Cardenas invested, she also did not understand that the insured had to die
13 before she could receive the return of her investment.

14 23. Since Mrs. Cardenas was 70 at the time she invested, she had to have access to this
15 money within two years because these were IRA funds upon which she would need to make
16 mandatory withdrawals and pay taxes. She again relied on Respondent Krizman's representations to
17 her that liquidating her investment would not be a problem and that she could withdraw her money
18 within two years.

19 24. Respondent Krizman failed to disclose any potential investment risks associated with
20 the Alpha viatical to Mrs. Cardenas such as how the insured/viator's life expectancy might affect her
21 investment return. Additionally, Respondent Krizman never explained the difference between a
22 contestable and uncontestable policy.

23 25. At the hearing, Mrs. Cardenas testified that her 1998 Alpha viatical contract has not
24 yet matured or paid her any return.

25 26. Mrs. Elaine Haber (formerly Green), a 68-year old college-educated widow who has
26 never been employed, also testified telephonically from Tucson about her Alpha viatical investment
27 with Respondent Krizman.
28

1 27. Mrs. Haber described herself as an inexperienced investor with limited investment
2 experience. Prior to her dealings with Respondent Krizman, Mrs. Haber's investment experience
3 consisted of only slight knowledge of the investments made previously by her husband.

4 28. After Mrs. Haber's husband died in 1998, her only other investment which she made
5 on her own besides the Alpha viatical contract involved the purchase of shares in an Eaton Vance
6 mutual fund sold to her by Respondent Krizman.

7 29. On August 25, 1998, Mrs. Haber invested \$45,000 in an Alpha viatical contract with
8 Mr. Krizman.

9 30. Although Mrs. Haber testified that a number of factors entered into her decision to
10 invest in the Alpha viatical contract, none of them were relevant to making a sound investment
11 decision. Mrs. Haber trusted Respondent Krizman and her trust was heightened by the fact that she
12 was in a vulnerable state of mind due to her husband's death at the time of her investment.

13 31. Mrs. Haber was led to believe by Mr. Krizman that she would double her money and
14 that if her investment in a viatical contract did not pay a return during her lifetime, her children would
15 receive its benefits.

16 32. Although Mrs. Haber was also led to believe that she could sell her viatical investment
17 at any time, after she read a newspaper article stating viaticals were poor investments, she was unable
18 to sell it.

19 33. Respondent Krizman did not disclose any potential risks associated with the Alpha
20 viatical investment to Mrs. Haber including any risks associated with purchasing a contestable policy.
21 In fact, Mrs. Haber could not recall any discussion about the fact that she was purchasing a
22 contestable policy.

23 34. Mrs. Haber testified that she believes the reason her Alpha viatical contracts have not
24 paid her a return is because Alpha went bankrupt.

25 35. Mr. Michael Donovan, a Division senior financial institution examiner for five and
26 one-half years, testified on general securities practices. Mr. Donovan has twenty-two years
27 experience in the securities industry including sixteen and one-half years as a registered securities
28

1 salesman. He has received securities training from Merrill Lynch and the Division.

2 36. Mr. Donovan testified that he is familiar with the National Association of Securities
3 Dealers ("NASD") Conduct Rules ("Conduct Rules") and in particular the Conduct Rules governing
4 private securities transactions and outside business activities.

5 37. As a NASD member firm, the Conduct Rules apply to SunAmerica and Respondent
6 Krizman.

7 38. The Conduct Rules prohibit a salesman from selling products that are not approved by
8 the salesman's broker dealer, and a securities salesman is required to notify and receive approval
9 from his broker dealer prior to selling any investment products not approved by the firm.

10 39. When a salesman sells an unapproved product, the practice is known as "selling
11 away"; and Arizona prohibits selling away under A.R.S. §44-1962(10) and A.A.C. R14-4-130(7).

12 40. SunAmerica's sales practice manual in effect at the time Respondent Krizman effected
13 the Alpha viatical sales contained sections titled "Prohibited Sales and Business Practices", "Outside
14 Business Activities", and "Private Securities Transactions" that clearly prohibited selling investment
15 products, including alternative investment products, that were not approved for sale, and accepting
16 compensation directly or indirectly from other than SunAmerica in connection with any securities
17 transactions.

18 41. During his EUO, Respondent Krizman testified that he was familiar with the topics
19 covered by SunAmerica's sales practices manual and that he was aware that selling away was
20 prohibited.

21 42. The Alpha viatical contracts sold by Mr. Krizman were not an investment product
22 approved for sale by SunAmerica's salesmen.

23 43. From the NASD's Central Registration Database ("CRD"), Mr. Donovan noted that an
24 Alpha viatical investor, Russell Le Blanc, filed a complaint with SunAmerica on February 15, 2002
25 against Respondent Krizman concerning Mr. Le Blanc's viatical purchases. Subsequently, according
26 to the CRD records, SunAmerica reported that it conducted an internal review on February 25, 2002
27 into a customer complaint and, as a result of that review, it terminated Respondent Krizman for
28

1 selling a product that was not on the approved list and because the requisite disclosures had not been
2 submitted for review and approval.

3 44. Since July 18, 2000, a viatical settlement has been defined as a security under the Act.
4 Subsequent to that date, the Arizona Court of Appeals in Siporin v. Carrington, 23 P.3d. 92 (April 19,
5 2001), concluded that viatical settlements sold to an Arizona investor in 1997 fell within the
6 definition of an investment contract and were thus, securities under the Act. Although this case
7 conflicts with a decision by the federal Court of Appeals for the District of Columbia in Sec. & Exch.
8 Comm'n v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir.) *pet. for reh. en banc denied*, 102 F.3d 587
9 (D.C. Cir. 1996), the Siporin court clearly stated that reliance on Life Partners was a "voluntarily
10 assumed business risk". Siporin, 23 P.3d. 92, 99.

11 45. We believe that the Life Partners case is not binding in Arizona and we believe
12 Arizona investors are better and more appropriately protected by the Arizona decision. The fact that
13 there had not been an amendment to the Act to define a viatical settlement as a security prior to the
14 Alpha viatical sales by Respondent Krizman does not preclude our finding that the Alpha viatical
15 contracts were securities as investment contracts subject to regulation under the Act and that
16 Respondent Krizman sold securities that were not registered with the Division or exempt from
17 registration.

18 46. With respect to the allegations by the Division that Respondent Krizman engaged in
19 fraud in the sale of securities, based on the record, Respondent Krizman violated A.R.S. §44-
20 1991(A)(2) by misrepresenting to investors that they would double their money, by failing to disclose
21 material facts regarding risks that could substantially impact the return on the investment such as that
22 contestable policies were subject to forfeiture with the potential loss of the entire investment or that
23 the longer the viator/insured lived, the lower the rate of return. Additionally, Respondent Krizman
24 misrepresented to investors the following: that the Alpha viatical contracts were entirely safe high-
25 yield investments; and that investors could readily liquidate their Alpha viatical contracts within two
26 years, when there was no public market for these investments. Respondent Krizman also failed to
27 disclose to investors the difference between contestable policies and non-contestable policies.
28

47. With respect to the offer and sale of the Alpha viatical contracts, we believe Respondent Krizman violated the Act and he should be ordered to permanently cease and desist from violating the Act.

48. With respect to restitution, we believe Respondent Krizman should make restitution to each of the six identified Arizona investors in the amount each invested for a total restitution obligation of \$439,715.62. With respect to administrative penalties for violations of the Act by Respondent Krizman, we believe that because Respondent violated the Act's registration provisions, the Act's Unethical and Dishonest Practices Rule on selling away and the Act's anti-fraud provisions, Respondent Krizman should be liable for an administrative penalty of \$66,000.

49. With respect to the revocation of Respondent Krizman's securities salesman's registration, the evidence clearly supports the aforementioned violations of the Act and warrants revoking his registration as a securities salesman.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and A.R.S. §44-1801 et seq.

2. The investments in the form of viatical settlement contracts offered and sold by Respondent Krizman are investment contracts and thus securities within the meaning of A.R.S. §44-1801(26).

3. The viatical settlement contracts were neither registered nor exempt from registration, in violation of A.R.S. §44-1841.

4. Respondent Krizman offered and sold unregistered securities in violation of A.R.S. §44-1841.

5. Respondent Krizman's conduct in connection with the offer and sale of viatical settlement contracts violated A.R.S. § 44-1991(A)(2).

6. Respondent Krizman's conduct in connection with the offer and sale of viatical settlement contracts violated A.R.S. §44-1962(10), Rule R14-4-130(7).

7. Respondent Krizman violated the Act and should cease and desist from any future violations of the Act pursuant to A.R.S. §44-2032.

8. Respondent Krizman violated the Act and should make restitution to each of the six identified Arizona Alpha viatical investors as set forth in Findings of Fact No. 11 for a restitution obligation totaling \$439,715.62 pursuant to A.R.S. §44-1962 and 2032 in accordance with A.C.C. R14-4-208(C) including interest pursuant to A.R.S. §44-1201.

9. Respondent Krizman should be assessed administrative penalties pursuant to A.R.S. §44-2036 as follows: for the violations of A.R.S. §44-1841 the sum of \$18,000; for the violations of A.R.S. §44-1991(A)(2) the sum of \$30,000; and for the violations of A.R.S. §44-1962(10), A.A.C. R14-4-130(7) the sum of \$18,000.

10. Respondent Krizman violated the Act and his securities salesman's registration should be revoked pursuant to A.R.S. §44-1962.

ORDER

IT IS THEREFORE ORDERED that pursuant to the authority granted to the Commission under A.R.S. §44-2032, Respondent Krizman shall cease and desist from any future violations of the Act.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. §§44-1962, 44-2032 and A.C.C. R14-4-308, Respondent Krizman shall make restitution consistent with Findings of Fact No. 11 and Conclusion of Law No. 8 payable in full within 90 days from the effective date of this Decision.

IT IS FURTHER ORDERED that restitution shall bear interest at the rate of 10 percent per year for the period beginning from the date of each investment to the date of payment of restitution by Respondent Krizman.

IT IS FURTHER ORDERED that all restitution payments shall be deposited into an interest-bearing account(s) if appropriate, until distributions are made.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. §44-2036, Respondent Krizman shall pay administrative penalties for the violations of A.R.S.

§44-1841 the sum of \$18,000; for the violations of A.R.S. §44-1991(A)(2) the sum of \$30,000; and for the violations of A.R.S. §44-1962(10), A.A.C. R14-4-130(7) the sum of \$18,000.

IT IS FURTHER ORDERED that the administrative penalties hereinabove shall be made payable to the State Treasurer for deposit in the general fund for the State of Arizona.

IT IS FURTHER ORDERED that the administrative penalties ordered hereinabove shall bear interest at the rate of 10 percent per year for any outstanding balance after 60 days from the effective date of this Decision.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. §44-1962, Respondent Krizman's securities salesman's registration, be and is hereby, revoked.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____, 2003.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

MES:mlj

1 SERVICE LIST FOR: DAVID R. KRIZMAN

2 DOCKET NO.: S-03486A-02-0000

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